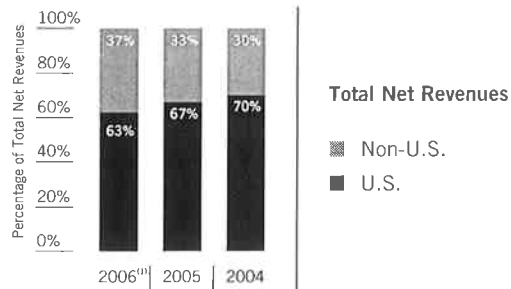


The following chart illustrates U.S. and non-U.S. net revenues as a percentage of total net revenues.



(1) Excludes the net gain of approximately \$2.0 billion resulting from the closing of the BlackRock merger.

For further geographic information, including our earnings by region and the methodology used in preparing this data, refer to Note 3 to the Consolidated Financial Statements.

Consolidated Balance Sheets

Overview

We continuously monitor and evaluate the size and composition of the Consolidated Balance Sheets. The following table summarizes the year-end and average balance sheets for 2006 and 2005:

(dollars in billions)	Dec. 29, 2006	2006 Average ⁽¹⁾	Dec. 30, 2005	2005 Average ⁽¹⁾
Assets				
Trading-Related				
Securities financing assets	\$ 321.9	\$362.1	\$272.3	\$268.3
Trading assets	203.8	193.9	148.7	182.9
Other trading-related receivables	71.7	69.5	54.3	60.9
	597.4	625.5	475.3	512.1
Non-Trading-Related				
Cash	45.6	37.8	26.5	38.7
Investment securities	83.4	70.8	69.3	71.2
Loans, notes, and mortgages, net	73.0	71.0	66.0	60.6
Other non-trading assets	41.9	43.0	43.9	47.8
	243.9	222.6	205.7	218.3
Total assets	\$ 841.3	\$848.1	\$681.0	\$730.4
Liabilities				
Trading-Related				
Securities financing liabilities	\$ 291.0	\$332.7	\$229.2	\$265.2
Trading liabilities	98.9	117.9	88.9	105.7
Other trading-related payables	75.6	80.2	56.9	63.8
	465.5	530.8	375.0	434.7
Non-Trading-Related				
Short-term borrowings	18.1	17.1	9.0	13.9
Deposits	84.1	81.1	80.0	79.2
Long-term borrowings	181.4	141.3	132.4	122.4
Junior subordinated notes (related to trust preferred securities)	3.8	3.1	3.1	3.1
Other non-trading liabilities	49.4	37.3	45.9	43.9
	336.8	279.9	270.4	262.5
Total liabilities	802.3	810.7	645.4	697.2
Total stockholders' equity	39.0	37.4	35.6	33.2
Total liabilities and stockholders' equity	\$ 841.3	\$848.1	\$681.0	\$730.4

(1) Averages represent our daily balance sheet estimates, which may not fully reflect netting and other adjustments included in period-end balances. Balances for certain assets and liabilities are not updated on a daily basis.

The discussion that follows analyzes the changes in year-end financial statement balances and yearly average balances of the major asset and liability categories.



Trading-Related Assets and Liabilities

Trading-related balances primarily consist of securities financing transactions, trading assets and liabilities, and certain interest receivable/payable balances that result from trading activities. At December 29, 2006, total trading-related assets and liabilities were \$597.4 billion and \$465.5 billion, respectively. Average trading-related assets and liabilities for 2006 were \$625.5 billion and \$530.8 billion, respectively.

The increases in trading-related assets and liabilities in 2006 primarily reflect higher levels of securities financing activity, which includes increased client matched-book transactions. We continued to expand our prime brokerage businesses during the year, which resulted in increases in securities financing transactions and other trading-related receivables.

Although trading-related balances comprise a significant portion of the Consolidated Balance Sheets, the magnitude of these balances does not necessarily result in an increase in risk. The market and credit risks associated with trading-related balances are mitigated through various hedging strategies, as discussed in the following section. See Note 6 to the Consolidated Financial Statements for descriptions of market and credit risks.

We reduce a significant portion of the credit risk associated with trading-related assets by requiring counterparties to post cash or securities as collateral in accordance with collateral maintenance policies. Conversely, we may be required to post cash or securities to counterparties in accordance with similar policies.

Securities Financing Transactions

Securities financing transactions include resale and repurchase agreements, securities borrowed and loaned transactions, securities received as collateral, and obligations to return securities received as collateral. Repurchase agreements and, to a lesser extent, securities loaned transactions are used to fund a portion of trading assets. Likewise, we use resale agreements and securities borrowed transactions to obtain the securities needed for delivery on short positions. These transactions are typically short-term in nature, with a significant portion entered into on an overnight or open basis.

We also enter into matched-book transactions to meet clients' needs. These matched-book repurchase and resale agreements or securities borrowed and loaned transactions are entered into with different clients using the same underlying securities, generating a spread between the interest revenue on the resale agreements or securities borrowed transactions and the interest expense on the repurchase agreements or securities loaned transactions. Our exposures on these transactions are limited by collateral maintenance policies and the typically short-term nature of the transactions.

Securities financing assets at year-end 2006 were \$321.9 billion, up 18% from 2005 year-end, and securities financing liabilities were \$291.0 billion at 2006 year-end, up 27% from year-end 2005. Average securities financing assets in 2006 were \$362.1 billion, up 35% from the 2005 average. Average securities financing liabilities in 2006 were \$332.7 billion, up 25% from the 2005 average.

Trading Assets and Liabilities

Trading inventory principally represents securities purchased ("long positions"), securities sold but not yet purchased ("short positions"), the fair value of derivative contracts, and commodities and related contracts. See Note 1 to the Consolidated Financial Statements for related accounting policies. These positions primarily arise from market-making, hedging, and proprietary activities.

We act as a market maker in a wide range of securities, resulting in a significant amount of trading inventory that is required to facilitate client transaction flow. We also maintain inventory for our proprietary trading activities, where we seek to profit from existing or projected market opportunities.

We use both "cash instruments" (e.g., securities) and derivatives to manage trading inventory market risks. As a result of these economic hedging techniques, a significant portion of our trading assets and liabilities represents hedges of other trading positions. We may use long positions in U.S. Government securities, for example, to hedge our short positions in interest rate futures contracts. These hedging techniques, which are generally initiated at the trading unit level, are supplemented by corporate risk management policies and procedures (see the Risk Management section for a description of risk management policies and procedures).

Trading assets at year-end 2006 were \$203.8 billion, up 37% from 2005, and trading liabilities at year-end 2006 were \$98.9 billion, up 11% from 2005. Average trading assets in 2006 were \$193.9 billion, up 6% from the 2005 average. Average trading liabilities in 2006 were \$117.9 billion, up 12% from the 2005 average.

Other Trading-Related Receivables and Payables

Securities trading may lead to various customer or broker-dealer receivable and payable balances. Broker-dealer receivable and payable balances may also result from recording trading inventory on a trade date basis. Certain receivable and payable balances also arise when customers or broker-dealers fail to pay for securities purchased or fail to deliver securities sold, respectively. These receivables are generally collateralized by the securities that the customer or broker-dealer purchased but did not receive. Customer receivables also include certain commodities transactions, margin loans and similar loan arrangements collateralized by customer-owned securities that we hold. Collateral

policies significantly limit our credit exposure to customers and broker-dealers. In accordance with regulatory requirements, we will sell securities that have not been paid for, or purchase securities sold but not delivered, after a relatively short period of time, or will require additional margin collateral, as necessary. These measures reduce market risk exposure related to these balances.

Interest receivable and payable balances related to trading inventory are principally short-term in nature. We consider interest balances for resale and repurchase agreements and securities borrowed and loaned transactions when determining the collateral requirements related to these transactions.

Other trading-related receivables at year-end 2006 were \$71.7 billion, up 32% from 2005, and other trading-related payables were \$75.6 billion at year-end 2006, up 33% from 2005. Average other trading-related receivables in 2006 were \$69.5 billion, up 14% from the 2005 average. Average other trading-related payables were \$80.2 billion in 2006, up 26% from the 2005 average.

Non-Trading-Related Assets and Liabilities

Non-trading-related balances primarily consist of cash; investment securities; loans, notes, and mortgages; short- and long-term borrowings; and other non-trading assets and liabilities. At December 29, 2006, total non-trading-related assets and liabilities were \$243.9 billion and \$336.8 billion, respectively. Average non-trading-related assets for 2006 were \$222.6 billion, and average non-trading-related liabilities were \$279.9 billion.

Cash

Cash includes cash, cash equivalents and cash and securities segregated for regulatory purposes or deposited with clearing organizations. Cash at year-end 2006 was \$45.6 billion, up 72% from 2005. Average cash in 2006 was \$37.8 billion, down 2% from the 2005 average.

Investment Securities

Investment securities principally consist of debt securities, including those that we hold for investment and liquidity and collateral management purposes; equity securities; and private equity investments, including investments in partnerships and joint ventures.

Investment securities were \$83.4 billion at year-end 2006, up 20% from 2005. Average investment securities were \$70.8 billion in 2006, down 1% from the 2005 average. See Note 5 to the Consolidated Financial Statements for further information.

Loans, Notes, and Mortgages, net

Our portfolio of loans, notes, and mortgages includes corporate and institutional loans, residential and commercial mortgages, asset-based loans and other loans to individuals and other businesses. We maintain collateral to mitigate risk of loss in the event of default on some of these extensions of credit in the form of securities, liens on real estate, perfected security interests in other assets of the borrower or other loan parties, and guarantees. We also economically hedge portions of the credit risk in certain commercial loans by purchasing credit default swaps. Loans, notes, and mortgages were \$73.0 billion at year-end 2006, up 11% from 2005 as a result of strong market demand driven by favorable borrower fundamentals and business growth. Average loans, notes, and mortgages in 2006 were \$71.0 billion, up 17% from the 2005 average. These amounts do not include loans held for trading purposes, which are included in trading assets. See Note 8 to the Consolidated Financial Statements for additional information.

Borrowings and Deposits

Portions of trading and non-trading assets are funded through short- and long-term borrowings and deposits. See the Capital and Funding section for further information on funding sources.

Our short-term borrowings were \$18.1 billion at 2006 year-end, up from \$9.0 billion at the end of 2005. This increase in short-term borrowings was driven primarily by a \$4.7 billion increase in our secured short-term borrowings and a \$2.9 billion increase in commercial paper. A portion of our short-term borrowings are secured under a master note lending program, and these notes are similar in nature to other collateralized financing sources such as securities sold under agreements to repurchase. The average short-term borrowings balance in 2006 was \$17.1 billion, up 23% from the 2005 average. See Note 9 to the Consolidated Financial Statements for additional information.

Long-term borrowings, excluding junior subordinated notes (related to trust preferred securities), were \$181.4 billion at year-end 2006, up 37% from year-end 2005 to support business growth. Average long-term borrowings, excluding junior subordinated notes (related to trust preferred securities), in 2006 were \$141.3 billion, up 15% from the 2005 average. Junior subordinated notes (related to trust preferred securities) were \$3.8 billion at year-end 2006, up from \$3.1 billion at year-end 2005. For capital management purposes, we view trust preferred securities as a component of equity capital, although the junior subordinated notes (related to trust preferred securities) are recorded as a liability for accounting purposes. Deposits were \$84.1 billion at year-end 2006, up 5% from 2005. Average deposits in 2006 were \$81.1 billion, up 2% from the 2005 average.

Other Non-Trading Assets and Liabilities

Other non-trading assets, which include separate accounts assets, equipment and facilities, goodwill and other intangible assets, other non-interest receivables (\$17.8 billion in 2006 and \$14.0 billion in 2005) and other assets, were \$41.9 billion at year-end 2006, down 4% from



2005. Average other non-trading assets in 2006 were \$43.0 billion, down 10% from the 2005 average. Separate accounts assets are related to our insurance businesses and represent segregated funds that are invested for certain policyholders and other customers. The assets of each account are legally segregated and are generally not subject to claims that arise from any of our other businesses.

Other non-trading liabilities, which include liabilities of insurance subsidiaries, separate accounts liabilities, and other non-interest payables (\$34.3 billion in 2006 and \$26.8 billion in 2005), were \$49.4 billion at year-end 2006, up 7% from 2005. Average other non-trading liabilities were \$37.3 billion in 2006, down 15% from the 2005 average. Separate accounts liabilities represent our obligations to our customers related to separate accounts assets.

Stockholders' Equity

Stockholders' equity at December 29, 2006 was \$39.0 billion, up 10% from December 30, 2005. This increase primarily resulted from net earnings, preferred stock issuances and the net effect of employee stock transactions, partially offset by common stock repurchases and dividends.

At December 29, 2006, total common shares outstanding, excluding shares exchangeable into common stock, were 864.7 million, 6% lower than the 915.6 million shares outstanding at December 30, 2005. The decrease reflected common stock repurchases, partially offset by shares issued to employees.

Total shares exchangeable into common stock at year-end 2006 were 2.7 million, essentially unchanged from year-end 2005. For additional information, see Note 11 to the Consolidated Financial Statements.

Off-Balance Sheet Arrangements

As a part of our normal operations, we enter into various off-balance sheet arrangements that may require future payments. The table below outlines our significant off-balance sheet arrangements, as well as the future expiration as of December 29, 2006:

(dollars in millions)	Expiration				
	Total	Less than 1 Year	1-3 Years	3+ Years	Over 5 Years
Liquidity and default facilities with SPEs ⁽¹⁾	\$ 49,180	\$ 46,688	\$ 2,231	\$ 97	\$ 164
Residual value guarantees ⁽²⁾	990	46	414	123	407
Standby letters of credit and other guarantees ⁽³⁾	4,333	1,576	593	1,812	352

(1) Amounts relate primarily to liquidity facilities and credit default protection provided to municipal bond securitization SPEs and asset-backed commercial paper conduits that we sponsor.

(2) Includes residual value guarantees associated with the Hopewell campus and aircraft leases of \$322 million.

(3) Includes \$66 million of reimbursement agreements with the Mortgage 100SM program, guarantees related to principal-protected mutual funds, and certain indemnifications related to foreign tax planning strategies.

We provide guarantees to Special Purpose Entities ("SPEs") in the form of liquidity facilities, credit default protection and residual value guarantees for equipment leasing entities. The liquidity facilities and credit default protection relate primarily to municipal bond securitization SPEs and asset-backed commercial paper conduits. To protect against declines in value of the assets held by the SPEs for which we provide either liquidity facilities or default protection, we generally economically hedge our exposure through derivative positions that principally offset the risk of loss of these guarantees. The residual value guarantees are primarily related to leasing SPEs where either we or a third-party is the lessee. We also make guarantees to counterparties in the form of standby letters of credit and reimbursement agreements issued in conjunction with sales of loans originated under our Mortgage 100SM program. At December 29, 2006, we held \$539 million of marketable securities as collateral to secure these guarantees. In conjunction with certain principal-protected mutual funds, we guarantee the return of the initial principal investment at the termination date of the fund. We also provide indemnifications related to the U.S. tax treatment of certain foreign tax planning transactions. The maximum exposure to loss associated with these transactions is \$165 million; however, we believe that the likelihood of loss with respect to these arrangements is remote.

The amounts in the preceding table show the maximum future cash flow requirements and therefore do not represent expected future cash flow requirements. Refer to Note 7 and Note 12 to the Consolidated Financial Statements for a further discussion of these arrangements.

Contractual Obligations and Commitments

Contractual Obligations

In the normal course of business, we enter into various contractual obligations that may require future cash payments. The table below summarizes our contractual obligations by remaining maturity at December 29, 2006. Excluded from this table are obligations recorded on the Consolidated Balance Sheets that are: (i) generally short-term in nature, including securities financing transactions, trading liabilities, including contractual agreements, short-term borrowings and other payables; (ii) deposits; (iii) obligations that are related to our insurance subsidiaries, including liabilities of insurance subsidiaries, which are subject to significant variability; and (iv) separate accounts liabilities, which fund separate accounts assets.

(dollars in millions)	Expiration				
	Total	Less than 1 Year	1–3 Years	3+–5 Years	Over 5 Years
Long-term borrowings	\$ 181,400	\$ 38,180	\$ 61,209	\$ 38,656	\$ 43,355
Purchasing and other commitments	14,439	10,597	1,224	566	2,052
Junior subordinated notes (related to trust preferred securities)	3,813	—	—	—	3,813
Operating lease commitments	3,275	567	1,067	850	791

We issue U.S. and non-U.S. dollar-denominated long-term borrowings with both variable and fixed interest rates, as part of our overall funding strategy. For further information on funding and long-term borrowings, see the Capital and Funding section and Note 9 to the Consolidated Financial Statements. In the normal course of business, we enter into various noncancellable long-term operating lease agreements, various purchasing commitments, commitments to extend credit and other commitments. For detailed information regarding these commitments, see Note 12 to the Consolidated Financial Statements.

Commitments

At December 29, 2006, our commitments had the following expirations:

(dollars in millions)	Expiration				
	Total	Less than 1 Year	1–3 Years	3+–5 Years	Over 5 Years
Commitments to extend credit	\$ 96,370	\$ 52,728	\$ 11,561	\$ 22,580	\$ 9,501
Commitments to enter into resale agreements	10,304	10,304	—	—	—

For further information regarding these commitments, see Note 12 to the Consolidated Financial Statements.

Capital and Funding

The primary objectives of our capital management and funding strategies are as follows:

- Maintain sufficient long-term capital to support the execution of our business strategies and to achieve our financial performance objectives;
- Ensure liquidity across market cycles and through periods of financial stress; and
- Comply with regulatory capital requirements.

Long-Term Capital

Our long-term capital sources include equity capital, long-term borrowings and certain deposits in bank subsidiaries that we consider to be long-term or stable in nature.

At December 29, 2006 and December 30, 2005, total long-term capital consisted of the following:

(dollars in millions)	2006	2005
Common equity	\$ 35,893	\$ 32,927
Preferred stock	3,145	2,673
Trust preferred securities ⁽¹⁾	3,323	2,544
Equity capital	42,361	38,144
Subordinated long-term borrowings	6,429	—
Senior long-term borrowings ⁽²⁾	120,122	96,361
Deposits ⁽³⁾	71,204	70,271
Total long-term capital	\$ 240,116	\$ 204,776

(1) Represents junior subordinated notes (related to trust preferred securities), net of related investments. The related investments are reported as investment securities and were \$490 million at December 29, 2006 and \$548 million at December 30, 2005.

(2) Excludes junior subordinated notes, (related to trust preferred securities), the current portion of long-term borrowings and the long-term portion of other subsidiary financing that is non-recourse to or not guaranteed by ML & Co. Borrowings that mature in more than one year, but contain provisions whereby the holder has the option to redeem the obligations within one year, are reflected as current portion of long-term borrowings and are not included in long-term capital.

(3) Includes \$59,341 million and \$11,863 million of deposits in U.S. and non-U.S. banking subsidiaries, respectively, in 2006, and \$60,575 million and \$9,696 million of deposits, respectively, in 2005 that we consider to be long-term based on our liquidity models.

At December 29, 2006, our long-term capital sources of \$240.1 billion exceeded our estimated long-term capital requirements. See Liquidity Risk in the Risk Management Section for additional information.



Equity Capital

At December 29, 2006, equity capital, as defined by Merrill Lynch, was \$42.4 billion and comprised of \$35.9 billion of common equity, \$3.1 billion of preferred stock, and \$3.3 billion of trust preferred securities. We define equity capital more broadly than stockholders' equity under U.S. generally accepted accounting principles, as we include other capital instruments with equity-like characteristics such as trust preferred securities. We view trust preferred securities as equity capital because they are either perpetual or have maturities of at least 60 years at issuance. These trust preferred securities represent junior subordinated notes, net of related investments. Junior subordinated notes (related to trust preferred securities) are reported on the Consolidated Balance Sheets as a liability for accounting purposes. The related investments are reported as investment securities on the Consolidated Balance Sheets.

We regularly assess the adequacy of our equity capital base relative to the estimated risks and needs of our businesses, the regulatory and legal capital requirements of our subsidiaries, standards required by the CSE rules and considerations of rating agencies. Refer to Note 16 to the Consolidated Financial Statements for additional information on regulatory requirements. We also assess the impact of our capital structure on financial performance metrics.

We developed economic capital models to determine the amount of equity capital we need to cover potential losses arising from market, credit and operational risks. We developed these statistical risk models in conjunction with our risk management practices, and they allow us to attribute an amount of equity to each of our businesses that reflects the risks of that business, both on- and off-balance sheet. We review regularly and refine periodically models and other tools used to estimate risks, as well as the assumptions used in those models and tools to provide a reasonable and conservative assessment of our risks across a stressed market cycle. We also assess the need for equity capital to support risks that may not be adequately measured through these risk models. When we deem prudent, we purchase insurance to protect against certain risks.

In addition, we consider how much equity capital we may need to support normal business growth and strategic initiatives. In the event that we generate common equity capital beyond our estimated needs, we seek to return that capital to shareholders through share repurchases and dividends, considering the impact on our financial performance metrics.

The major components of the changes in equity capital for 2006 and 2005 are as follows:

(dollars in millions)	2006	2005
Beginning of year	\$ 38,144	\$ 33,914
Net earnings	7,499	5,116
Issuance of preferred stock, net of repurchases and re-issuances	472	2,043
Issuance of trust preferred securities, net of redemptions and related investments	779	—
Common and preferred stock dividends	(1,106)	(777)
Common stock repurchases	(9,088)	(3,700)
Net effect of employee stock transactions and other ⁽¹⁾	5,661	1,548
End of year	\$ 42,361	\$ 38,144

(1) Includes the impact of our adoption of SFAS No. 123R and related policy modifications to previous stock awards, as well as accumulated other comprehensive loss and other items.

Our equity capital of \$42.4 billion at December 29, 2006 increased \$4.2 billion, or 11%, from December 30, 2005. Equity capital increased in 2006 primarily through net earnings, issuance of preferred stock and trust preferred securities and the net effect of employee stock transactions, including the impact of our adoption of SFAS No. 123R and related policy modifications to previous stock awards. The equity capital increase was partially offset by common stock repurchases, dividends and the redemption of trust preferred securities.

During 2006 and 2005, we issued \$360 million and \$2.2 billion face value, respectively, of floating and fixed rate, non-cumulative, perpetual preferred stock. Refer to Note 11 to the Consolidated Financial Statements for additional information.

On December 14, 2006, Merrill Lynch Capital Trust I issued \$1,050 million of 6.45% trust preferred securities. On December 29, 2006, Merrill Lynch Preferred Capital Trust I redeemed all of the outstanding \$275 million of 7.75% trust preferred securities. Refer to Note 9 to the Consolidated Financial Statements for additional information.

On January 18, 2006, the Board of Directors declared a 25% increase in the regular quarterly dividend to 25 cents per common share. On January 17, 2007, the Board of Directors declared an additional 40% increase in the regular quarterly dividend to 35 cents per common share.

In 2005 and 2006, the Board of Directors authorized three share repurchase programs to provide greater flexibility to return capital to shareholders. For the year ended December 30, 2005, we repurchased a total of 63.1 million shares of common stock at a cost of \$3.7 billion. For the year ended December 29, 2006, we repurchased a total of 116.6 million shares of common stock at a cost of \$9.1 billion. At December 29, 2006, we had \$3.2 billion of authorized repurchase capacity remaining from the \$5 billion repurchase program authorized in October 2006. At December 29, 2006, we had completed all other previously authorized share repurchase programs.

The table below sets forth the information with respect to purchases made by or on behalf of us or any “affiliated purchaser” of our common stock during the year ended December 29, 2006.

(dollars in millions, except per share amounts)

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Program ⁽¹⁾	Approximate Dollar Value of Shares that May Yet be Purchased Under the Program
First Quarter 2006 (Dec. 31, 2005 – Mar. 31, 2006)				
Capital Management Program	25,800,000	\$ 76.55	25,800,000	\$ 5,356
Employee Transactions ⁽²⁾	1,129,779	74.77	N/A	N/A
Second Quarter 2006 (Apr. 1 – Jun. 30)				
Capital Management Program	41,405,976	\$ 73.26	41,405,976	\$ 2,323
Employee Transactions ⁽²⁾	1,062,468	72.02	N/A	N/A
Third Quarter 2006 (Jul. 1 – Sep. 29)				
Capital Management Program	18,346,200	\$ 71.56	18,346,200	\$ 1,010
Employee Transactions ⁽²⁾	996,470	75.17	N/A	N/A
Month #10 (Sep. 30 – Nov. 3)				
Capital Management Program	8,036,600	\$ 85.87	8,036,600	\$ 5,320
Employee Transactions ⁽²⁾	256,299	84.49	N/A	N/A
Month #11 (Nov. 4 – Dec. 1)				
Capital Management Program	11,719,100	\$ 89.53	11,719,100	\$ 4,271
Employee Transactions ⁽²⁾	196,248	89.60	N/A	N/A
Month #12 (Dec. 2 – Dec. 29)				
Capital Management Program	11,303,000	\$ 90.92	11,303,000	\$ 3,243
Employee Transactions ⁽²⁾	170,694	90.80	N/A	N/A
Fourth Quarter 2006 (Sep. 30 – Dec. 29)				
Capital Management Program	31,058,700	\$ 89.09	31,058,700	\$ 3,243
Employee Transactions ⁽²⁾	623,241	87.83	N/A	N/A
Full Year 2006 (Dec. 31, 2005 – Dec. 29, 2006)				
Capital Management Program	116,610,876	\$ 77.94	116,610,876	\$ 3,243
Employee Transactions ⁽²⁾	3,811,958	76.24	N/A	N/A

(1) Share repurchases under the program were made pursuant to open-market purchases, Rule 10b5-1 plans or privately negotiated transactions as market conditions warranted and at prices we deemed appropriate.

(2) Included in the total number of shares purchased are: (i) shares purchased during the period by participants in the Merrill Lynch 401(k) Savings and Investment Plan (“401(k)”) and the Merrill Lynch Retirement Accumulation Plan (“RAP”), (ii) shares delivered or attested to in satisfaction of the exercise price by holders of ML & Co. employee stock options (granted under employee stock compensation plans) and (iii) Restricted Shares withheld (under the terms of grants under employee stock compensation plans) to offset tax withholding obligations that occur upon vesting and release of Restricted Shares. Our employee stock compensation plans provide that the value of the shares delivered or attested, or withheld, shall be the average of the high and low price of our common stock (Fair Market Value) on the date the relevant transaction occurs. See Notes 13 and 14 to the Consolidated Financial Statements for additional information on these plans.

Balance Sheet Leverage

Assets-to-equity leverage ratios are commonly used to assess a company's capital adequacy. We believe that a leverage ratio adjusted to exclude certain assets considered to have low risk profiles and assets in customer accounts financed primarily by customer liabilities provides a more meaningful measure of balance sheet leverage in the securities industry than an unadjusted ratio. We calculate adjusted assets by reducing total assets by (1) securities financing transactions and securities received as collateral less trading liabilities net of contractual agreements and (2) segregated cash and securities and separate accounts assets.

As leverage ratios are not risk sensitive, we do not rely on them to measure capital adequacy. When we assess our capital adequacy, we consider more sophisticated measures that capture the risk profiles of the assets, the impact of hedging, off-balance sheet exposures, operational risk and other considerations.



The following table provides calculations of our leverage ratios at December 29, 2006 and December 30, 2005:

(dollars in millions)	2006	2005
Total assets	\$841,299	\$ 681,015
Less: Receivables under resale agreements	178,368	163,021
Receivables under securities borrowed transactions	118,610	92,484
Securities received as collateral	24,929	16,808
Add: Trading liabilities, at fair value, excluding contractual agreements	60,551	60,178
Sub-total	579,943	468,880
Less: Segregated cash and securities balances	13,449	11,949
Separate accounts assets	12,314	16,185
Adjusted assets	554,180	440,746
Less: Goodwill and other intangible assets	2,457	6,035
Tangible adjusted assets	\$ 551,723	\$ 434,711
Stockholders' equity	\$ 39,038	\$ 35,600
Trust preferred securities ⁽¹⁾	3,323	2,544
Equity capital	\$ 42,361	\$ 38,144
Tangible equity capital ⁽²⁾	\$ 39,904	\$ 32,109
Leverage ratio ⁽³⁾	19.9x	17.9x
Adjusted leverage ratio ⁽⁴⁾	13.1x	11.6x
Tangible adjusted leverage ratio ⁽⁵⁾	13.8x	13.5x

(1) Represents junior subordinated notes, net of related investments. The related investments are reported as investment securities and were \$490 million at December 29, 2006 and \$548 million at December 30, 2005.

(2) Equity capital less goodwill and other intangible assets.

(3) Total assets divided by equity capital.

(4) Adjusted assets divided by equity capital.

(5) Tangible adjusted assets divided by tangible equity capital.

Funding

We fund our assets primarily with a mix of secured and unsecured liabilities through a globally coordinated funding strategy. We fund a portion of our trading assets with secured liabilities, including repurchase agreements, securities loaned and other short-term secured borrowings, which are less sensitive to our credit ratings due to the underlying collateral. A portion of our short-term borrowings are secured under a master note lending program. These notes are similar in nature to other collateralized financing sources such as securities sold under agreements to repurchase. Refer to Note 9 to the Consolidated Financial Statements for additional information regarding our borrowings.

We use unsecured liabilities to fund certain trading assets, as well as other long-dated assets not funded with equity. Our unsecured liabilities consist of the following:

(dollars in billions)	December 29, 2006	December 30, 2005
Commercial paper	\$ 6.4	\$ 3.4
Other unsecured short-term borrowings ⁽¹⁾	2.0	0.5
Current portion of long-term borrowings ⁽²⁾	37.7	21.9
Total unsecured short-term borrowings	46.1	25.8
Senior long-term borrowings ⁽³⁾	120.1	96.4
Subordinated long-term borrowings	6.4	—
Total unsecured long-term borrowings	126.5	96.4
Deposits	84.1	80.0

(1) Excludes \$9.8 billion and \$5.1 billion of secured short-term borrowings at December 29, 2006 and December 30, 2005, respectively; these short-term borrowings are represented under a master note lending program.

(2) Excludes \$460 million and \$850 million of the current portion of other subsidiary financing that is non-recourse or not guaranteed by ML & Co. at December 29, 2006 and December 30, 2005, respectively.

(3) Excludes junior subordinated notes (related to trust preferred securities), current portion of long-term borrowings, and the long-term portion of other subsidiary financing that is non-recourse or not guaranteed by ML & Co.

Our primary funding objectives are maintaining sufficient funding sources to support our existing business activities and future growth while ensuring that we have liquidity across market cycles and through periods of financial stress. To achieve our objectives, we have established a set of funding strategies that are described below:

- Diversify funding sources;
- Maintain sufficient long-term borrowings;
- Concentrate unsecured funding at ML & Co.;
- Use deposits as a source of funding; and
- Adhere to prudent governance principles.

Diversification of Funding Sources

We strive to diversify and expand our funding globally across programs, markets, currencies and investor bases. We issue debt through syndicated U.S. registered offerings, U.S. registered and 144A medium-term note programs, non-U.S. medium-term note programs, non-U.S. private placements, U.S. and non-U.S. commercial paper and through other methods. We distribute a significant portion of our debt offerings through our retail and institutional sales forces to a large, diversified global investor base. Maintaining relationships with our investors is an important aspect of our funding strategy. We also make markets in our debt instruments to provide liquidity for investors.

At December 29, 2006 and December 30, 2005, our total short- and long-term borrowings were issued in the following currencies:

(USD equivalent in millions)	2006		2005	
USD	\$ 120,852	61%	\$ 88,073	62%
EUR	43,323	22	27,313	19
JPY	11,822	6	11,225	8
GBP	10,228	5	8,269	6
AUD	3,777	1	2,329	2
CAD	2,727	1	2,377	2
CHF	1,487	1	529	—
INR	1,461	1	—	—
Other ⁽¹⁾	3,833	2	1,281	1
Total	\$ 199,510	100%	\$ 141,396	100%

Note: excludes junior subordinated notes (related to trust preferred securities).

(1) Includes various other foreign currencies, none of which individually exceed 1% of total issuances.

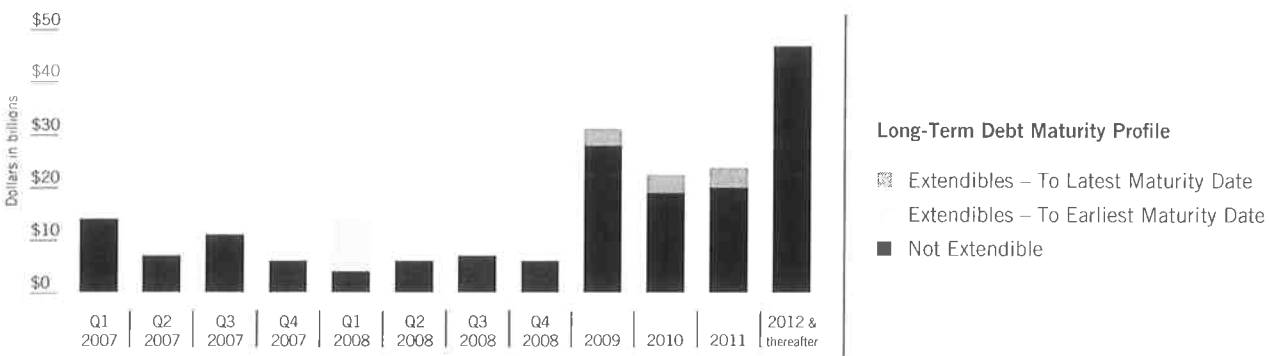
We also diversify our funding sources by issuing various types of debt instruments, including structured notes and extendible notes. Structured notes are debt obligations with returns that are linked to other debt or equity securities, indices, currencies or commodities. We typically hedge these notes with positions in derivatives and/or in the underlying instruments. We could be required to immediately settle certain structured note obligations for cash or other securities under certain circumstances, which we take into account for liquidity planning purposes. Structured notes outstanding were \$33.8 billion and \$19.4 billion at December 29, 2006 and December 30, 2005, respectively.

Extendible notes are debt obligations that have an extendible maturity. The initial maturity of the majority of our extendible notes is thirteen months. These notes automatically extend before they become current, unless the holders exercise their option to redeem the notes. Extendible notes are included in long-term borrowings while the remaining maturity is greater than one year. Based on current market conditions, we expect that these notes will automatically extend. Total extendible notes outstanding were \$10.6 billion and \$10.4 billion at December 29, 2006 and December 30, 2005, respectively.

Maintenance of Sufficient Long-Term Borrowings

An important objective of our asset-liability management is maintaining sufficient long-term borrowings to meet our long-term capital requirements. As such, we routinely issue debt in a variety of maturities and currencies to achieve cost efficient funding and an appropriate maturity profile. While the cost and availability of unsecured funding may be negatively impacted by general market conditions or by matters specific to the financial services industry or Merrill Lynch, we seek to mitigate this refinancing risk by actively managing the amount of our borrowings we anticipate will mature within any one month or quarter.

At December 29, 2006, the weighted average maturity of our long-term borrowings exceeded five years. The following chart presents our long-term borrowings maturity profile as of December 29, 2006 (quarterly for two years and annually thereafter):



Note: excludes junior subordinated notes (related to trust preferred securities).



The major components of the changes in our long-term borrowings, excluding junior subordinated notes (related to trust preferred securities), for 2006 and 2005 are as follows:

(dollars in billions)	2006	2005
Beginning of year	\$ 132.4	\$ 119.5
Issuance and resale	86.8	49.7
Settlement and repurchase	(42.2)	(31.2)
Other ⁽¹⁾	4.4	(5.6)
End of year ⁽²⁾	\$ 181.4	\$ 132.4

(1) Primarily foreign exchange movements.

(2) See the preceding chart and Note 9 to the Consolidated Financial Statements for additional information on our long-term borrowings maturity schedule.

Subordinated debt is an important part of our long-term borrowings. During 2006, ML & Co. issued \$6.4 billion of subordinated debt across various currencies and maturities ranging from 2016 through 2026. This subordinated debt was issued to satisfy certain anticipated CSE capital requirements. All of ML & Co.'s subordinated debt is junior in right of payment to ML & Co.'s senior indebtedness.

At December 29, 2006, senior and subordinated debt issued by ML & Co. or by subsidiaries and guaranteed by ML & Co. totaled \$182.4 billion. Except for the \$2.2 billion of zero-coupon contingent convertible debt (Liquid Yield Option Notes or "LYONs") that were outstanding at December 29, 2006, senior and subordinated debt obligations issued by ML & Co. and senior debt issued by subsidiaries and guaranteed by ML & Co. do not contain provisions that could, upon an adverse change in ML & Co.'s credit rating, financial ratios, earnings, cash flows, or stock price, trigger a requirement for an early repayment, additional collateral support, changes in terms, acceleration of maturity, or the creation of an additional financial obligation. See Note 9 to the Consolidated Financial Statements for additional information.

We use derivative transactions to more closely match the duration of borrowings to the duration of the assets being funded, thereby enabling interest rate risk to be within limits set by our Market Risk Management Group. Interest rate swaps also serve to convert our interest expense and effective borrowing rate principally to floating rate. We also enter into currency swaps to hedge assets that are not financed through debt issuance in the same currency. We hedge investments in subsidiaries in non-U.S. dollar currencies in whole or in part to mitigate foreign exchange translation adjustments in accumulated other comprehensive loss. See Notes 1 and 6 to the Consolidated Financial Statements for further information.

Concentration of Unsecured Funding at ML & Co.

ML & Co. is the primary issuer of all unsecured, non-deposit financing instruments that we use predominantly to fund assets in subsidiaries, some of which are regulated. The primary benefits of this strategy are greater control, reduced funding costs, wider name recognition by investors, and greater flexibility to meet variable funding requirements of subsidiaries. Where regulations, time zone differences, or other business considerations make this impractical, certain subsidiaries enter into their own financing arrangements. See Note 9 to the Consolidated Financial Statements for more information on borrowings.

Deposit Funding

At December 29, 2006, our bank subsidiaries had \$84.1 billion in customer deposits, which provide a diversified and stable base for funding assets within those entities. Our U.S. deposit base of \$62.3 billion includes an estimated \$52.9 billion of FDIC-insured deposits, which we believe are less sensitive to our credit ratings. We predominantly source deposit funding from our customer base in the form of our bank sweep programs and time deposits.

Deposits are not available as a source of funding to ML & Co. See Liquidity Risk in the Risk Management section for more information regarding our deposit liabilities.

Prudent Governance

We manage the growth and composition of our assets and set limits on the overall level of unsecured funding. Funding activities are subject to regular senior management review and control through Asset/Liability Committee meetings with Treasury management and other independent risk and control groups. Our funding strategy and practices are reviewed by the Risk Oversight Committee ("ROC"), Merrill Lynch's executive management and the Finance Committee of the Board of Directors.

Credit Ratings

The cost and availability of our unsecured funding are impacted by our credit ratings, and it is our objective to maintain high quality credit ratings. In addition, credit ratings are important when we compete in certain markets and when we seek to engage in certain long-term transactions, including OTC derivatives. Factors that influence our credit ratings include the credit rating agencies' assessment of the general operating environment, our relative positions in the markets in which we compete, our reputation, level and volatility of our earnings, our corporate governance and risk management policies, and our capital management practices.

On October 27, 2006, Standard & Poor's raised by one-notch ML & Co.'s senior debt rating to AA-, subordinated debt rating to A+, preferred stock rating to A and commercial paper rating to A-1+.

The following table sets forth ML & Co.'s unsecured credit ratings as of February 16, 2007. Rating agencies express outlooks from time to time on these credit ratings, and each of these agencies describes its current outlook as stable.

Rating Agency	Senior Debt Ratings	Subordinated Debt Ratings	Preferred Stock Ratings	Commercial Paper Ratings
Dominion Bond Rating Service Ltd.	AA (low)	A (high)	Not Rated	R-1 (middle)
Fitch Ratings	AA-	A+	A+	F1+
Moody's Investors Service, Inc.	Aa3	A1	A2	P-1
Rating & Investment Information, Inc. (Japan)	AA	Not Rated	A+	a-1+
Standard & Poor's Ratings Services	AA-	A+	A	A-1+

In connection with certain OTC derivatives transactions and other trading agreements, we could be required to provide additional collateral to certain counterparties in the event of a downgrade of the senior debt ratings of ML & Co. At December 29, 2006, the amount of additional collateral that would be required for such derivatives transactions and trading agreements was approximately \$511 million in the event of a one-notch downgrade and approximately \$789 million in the event of a two-notch downgrade of ML & Co.'s long-term senior debt credit ratings. We consider additional collateral on derivative contracts that may be required in the event of changes in ML & Co.'s credit ratings as part of our liquidity management practices.

Cash Flows

Our cash and cash equivalents increased \$17.5 billion to \$32.1 billion at year-end 2006. Cash flows from financing activities provided \$67.9 billion in 2006, primarily due to the issuances and resales of long-term borrowings, net of settlements and repurchases, of \$45.3 billion and cash from derivative financing transactions of \$16.3 billion. Cash flows used for investing activities in 2006 were \$11.0 billion and were primarily due to purchases of available-for-sale securities, net of sales and maturities, of \$2.0 billion, and cash used for other investments of \$6.5 billion. Cash flows used for operating activities in 2006 were \$39.4 billion and were primarily due to net cash used for trading assets and liabilities of \$61.5 billion, offset by increases in customer payables of \$13.8 billion.

Our cash and cash equivalents decreased \$6.2 billion to \$14.6 billion at year-end 2005. Cash flows from financing activities provided \$23.3 billion in 2005, primarily due to the issuances and resales of long-term borrowings, net of settlements and repurchases, of \$18.5 billion. Cash flows used for investing activities in 2005 were \$639 million and were primarily due to cash used for loans, notes, and mortgages transactions offset by cash flows from available-for-sale securities. Cash flows used for operating activities in 2005 were \$28.9 billion and were primarily due to cash used for resale agreements offset by cash received for repurchase agreements.

Risk Management

Risk Management Philosophy

Risk-taking is integral to the core businesses in which we operate. In the course of conducting our business operations, we are exposed to a variety of risks including market, credit, liquidity, operational and other risks that are material and require comprehensive controls and ongoing oversight. Senior managers of our core businesses are responsible and accountable for management of the risks associated with their business activities. In addition, independent risk groups manage market risk, credit risk, liquidity risk and operational risk. These independent risk groups fall under the management responsibility of our Chief Financial Officer. Along with other independent control groups, including Corporate Audit, Finance and the Office of General Counsel, these disciplines work to ensure risks are properly identified, measured, monitored, and managed throughout Merrill Lynch. To accomplish this, we have established a risk management process which includes:

- A formal risk governance structure that defines the oversight process and its components;
- A regular review of the risk management process by the Audit Committee of the Board of Directors (the "Audit Committee") as well as a regular review of credit, market and liquidity risks and processes by the Finance Committee of the Board of Directors ("the Finance Committee");
- Clearly defined risk management policies and procedures supported by a rigorous analytical framework;
- Communication and coordination among the businesses, executive management, and risk functions while maintaining strict segregation of responsibilities, controls, and oversight; and
- Clearly articulated risk tolerance levels, defined and regularly reviewed by the ROC, that are consistent with our business strategy, capital structure, and current and anticipated market conditions.

The risk management and control process ensures that our risk tolerance is well-defined and understood by our businesses as well as by our executive management. Independent risk and control groups interact with the core businesses to establish and maintain this overall risk management control process. While no risk management system can ever be absolutely complete, the goal of these independent risk and control groups is to mitigate risk-related losses so that they fall within acceptable, predefined levels, under foreseeable scenarios.



Risk Governance Structure

Our risk governance structure is comprised of the Audit Committee and the Finance Committee, the Executive Committee, the ROC, the business units, the independent risk and control groups, and various other corporate governance committees.

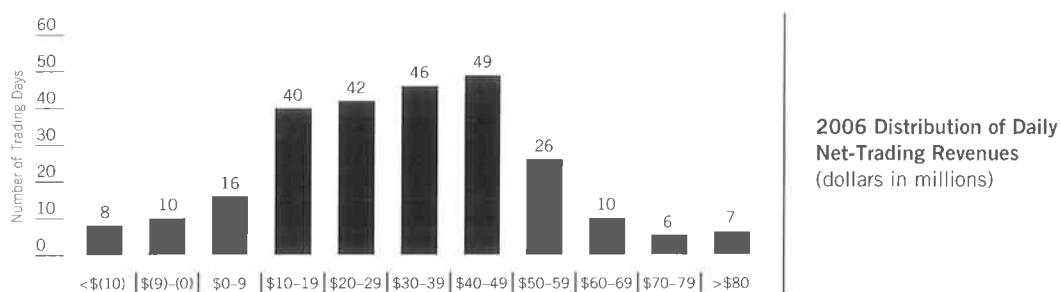
The Audit Committee, which is comprised entirely of independent directors, reviews and oversees management's policies and processes for managing all major categories of risk affecting the firm, including operational, legal and reputational risks. In addition, the Audit Committee also approves the ROC charter and has authorized the ROC to establish our risk management policies. The Finance Committee, which is also comprised entirely of independent directors, is responsible for reviewing our policies and procedures for managing exposure to market, credit and liquidity risk, including risk limits for both market and credit risk, Value at Risk ("VaR"), liquidity models, and other relevant models. The Executive Committee, a group comprised of executive management, approves the risk tolerance levels established by the ROC and receives regular updates from the ROC on risk-related matters. The Executive Committee pays particular attention to risk concentrations and liquidity concerns.

The ROC is comprised of senior business and control managers and is chaired by our Chief Financial Officer. The ROC establishes risk tolerance levels for the firm and authorizes material changes in our risk profile. The ROC works to ensure that the risks that we assume are managed within these tolerance levels and verifies that we have implemented appropriate processes to identify, measure, monitor and manage our risks.

Market and credit risk tolerance levels are represented in part by framework limits, which are established by the ROC and reviewed and approved annually by the Executive Committee, which must also approve certain intra-year changes. Substantive market and credit risk framework limit changes are reported to the Audit and Finance Committees. The frameworks are reviewed by the Finance Committee in the context of its evaluation of market and credit risk exposures. Risk framework exceptions and violations are reported and investigated at predefined and appropriate levels of management.

Both the Audit Committee and the Finance Committee are provided with regular risk updates, and significant issues and transactions are reported to the Executive Committee, the Audit Committee and the Finance Committee. Various governance committees exist to create policy, review activity, and verify that new and existing business initiatives remain within established risk tolerance levels. Representatives of the independent risk and control groups participate as voting members of these committees. The activities of these committees are monitored by the ROC.

The overall effectiveness of our risk processes and policies can be seen on a broader level when analyzing daily net trading revenues over time. Our policies and procedures for monitoring and controlling risk, combined with the businesses' focus on customer order-flow-driven revenues and selective proprietary positioning have helped us to mitigate earnings volatility within our trading portfolios. While no guarantee can be given regarding future earnings volatility, we will continue to pursue policies and procedures that assist us in measuring and monitoring our risks. The histogram below shows the distribution of daily net revenues from our trading businesses (principal transactions and net interest profit) for 2006.



Market Risk

We define market risk as the potential change in value of financial instruments caused by fluctuations in interest rates, exchange rates, equity and commodity prices, credit spread, and/or other risks. We have a Market Risk Framework that defines and communicates our market risk tolerance and broad overall limits across Merrill Lynch by defining and constraining exposure to specific asset classes, market risk factors and value at risk, or VaR. VaR is a statistical measure of the potential loss in the fair value of a portfolio due to adverse movements in underlying risk factors.

Our Market Risk Management Group and other independent risk and control groups are responsible for approving the products and markets in which our business units and functions will transact and take risk. Moreover, this group is responsible for identifying the risks to which these business units will be exposed in these approved products and markets. Market Risk Management uses a variety of quantitative methods to assess the risk of our positions and portfolios. In particular, Market Risk Management quantifies the sensitivities of our

current portfolios to changes in market variables. These sensitivities are then utilized in the context of historical data to estimate earnings and loss distributions that our current portfolios would have incurred throughout the historical period. From these distributions, Market Risk Management derives a number of useful risk statistics, including VaR.

The VaR disclosed in the accompanying table is an estimate of the amount that our current trading portfolios could lose with a specified degree of confidence, over a given time interval. The aggregate VaR for our trading portfolios is less than the sum of the VaRs for individual risk categories because movements in different risk categories occur at different times and, historically, extreme movements have not occurred in all risk categories simultaneously. The difference between the sum of the VaRs for individual risk categories and the VaR calculated for all risk categories is shown in the following table and may be viewed as a measure of the diversification within our portfolios. We believe that the tabulated risk measures provide broad guidance as to the amount we could lose in future periods, and we work continually to improve our measurement and the methodology of our VaR. However, the calculation of VaR requires numerous assumptions and thus VaR should not be viewed as a precise measure of risk. In addition, VaR is not intended to capture worst case scenario losses.

To calculate VaR, we aggregate sensitivities to market risk factors and combine them with a database of historical market factor movements to simulate a series of profits and losses. The level of loss that is exceeded in that series 5% of the time is used as the estimate for the 95% confidence level VaR. The overall total VaR amounts are presented across major risk categories, which include exposure to volatility risk found in certain products, such as options.

The table that follows presents our average and year-end VaR for trading instruments for 2006 and 2005. Additionally, high and low VaR for 2006 is presented independently for each risk category and overall. Because high and low VaR numbers for these risk categories may have occurred on different days, high and low numbers for diversification benefit would not be meaningful.

(dollars in millions)	Year-end 2006	Daily Average 2006	High 2006	Low 2006	Year-end 2005	Daily Average 2005
Trading Value-at-Risk ⁽¹⁾						
Interest rate and credit spread	\$ 48	\$ 48	\$ 66	\$ 33	\$ 37	\$ 37
Equity	29	19	39	5	16	12
Commodity	13	11	22	4	6	8
Currency	3	4	12	2	2	3
Subtotal ⁽²⁾	93	82			61	60
Diversification benefit	(41)	(32)			(23)	(25)
Overall⁽³⁾	\$ 52	\$ 50	\$ 71	\$ 30	\$ 38	\$ 35

(1) Based on a 95% confidence level and a one-day holding period.

(2) Subtotals are not provided for highs and lows as they are not meaningful.

(3) Overall trading VaR using a 95% confidence level and a one-week holding period was \$94 million and \$63 million at year-end 2006 and 2005, respectively.

Trading VaR increased during 2006 due to increased levels of equity, commodity and credit trading. If market conditions are favorable, we may increase our risk-taking in a number of our businesses, including our proprietary trading activities. These activities provide revenue opportunities while also increasing the loss potential under certain market conditions. We monitor these risk levels on a daily basis to verify they remain within corporate risk guidelines and tolerance levels.

To complement VaR and in recognition of its inherent limitations, we use a number of additional risk measurement methods and tools as part of our overall market risk management process. These include stress testing and event risk analysis, which examine portfolio behavior under significant adverse market conditions, including scenarios that would result in material losses for the firm.

Non-Trading Market Risk

Non-trading market risk includes the risks associated with certain non-trading activities, including investment securities, securities financing transactions and equity and certain principal investments. Also included are the risks related to funding activities. Risks related to lending activities are covered in the Credit Risk section that follows.

The primary market risk of non-trading investment securities and non-trading repurchase and reverse repurchase agreements is expressed as sensitivity to changes in the general level of credit spreads which are defined as the differences in the yields on debt instruments from relevant LIBOR/Swap rates. Non-trading investment securities include securities that are classified as available-for-sale and held-to-maturity as well as investments of insurance subsidiaries. At year-end 2006, the total credit spread sensitivity of these instruments was a pre-tax loss of \$24 million in fair market value for an increase of one basis point, which is one one-hundredth of a percent, in credit spreads, compared to a pre-tax loss of \$19 million at year-end 2005. This change in fair market value is a measurement of economic risk which may differ significantly in magnitude and timing from the actual profit or loss that would be realized under generally accepted accounting principles.



The interest rate risk associated with the non-trading positions, together with funding activities, is expressed as sensitivity to changes in the general level of interest rates. Our funding activities include LYONs®, trust preferred securities and other long-term debt issuances together with interest rate hedges. At year-end 2006, the net interest rate sensitivity of these positions is a pre-tax loss in fair market value of \$2 million for a parallel one basis point increase in interest rates across all yield curves, compared to a pre-tax loss of \$1 million at year-end 2005. This change in fair market value is a measurement of economic risk which may differ significantly in magnitude and timing from the actual profit or loss that would be realized under generally accepted accounting principles.

Other non-trading equity investments include direct private equity interests, private equity fund investments, hedge fund interests, certain direct and indirect real estate investments and other principal investments. These investments are broadly sensitive to general price levels in the equity or commercial real estate markets as well as to specific business, financial and credit factors which influence the performance and valuation of each investment uniquely. Refer to Note 5 to the Consolidated Financial Statements for additional information on these investments.

Credit Risk

We define credit risk as the potential for loss that can occur as a result of an individual, counterparty or issuer being unable or unwilling to honor its contractual obligations to us. The Credit Risk Framework is the primary tool that we use to communicate firm-wide credit limits and monitor exposure by constraining the magnitude and tenor of exposure to counterparty and issuer families. Additionally, we have country risk limits that constrain total aggregate exposure across all counterparties and issuers (including sovereign entities) for a given country within predefined tolerance levels.

We have a Global Credit and Commitments Group that assesses the creditworthiness of existing and potential individual clients, institutional counterparties and issuers, and determines firm-wide credit risk levels within the Credit Risk Framework among other tools. This group reviews and monitors specific transactions as well as portfolio and other credit risk concentrations both within and across businesses. This group is also responsible for ongoing monitoring of credit quality and limit compliance and actively works with all of our business units to manage and mitigate credit risk.

The Global Credit and Commitments Group uses a variety of methodologies to set limits on exposure and potential loss resulting from an individual, counterparty or issuer failing to fulfill its contractual obligations. The group performs analyses in the context of industrial, regional, and global economic trends and incorporates portfolio and concentration effects when determining tolerance levels. Credit risk limits take into account measures of both current and potential exposure as well as potential loss and are set and monitored by broad risk type, product type, and maturity. Credit risk mitigation techniques include, where appropriate, the right to require initial collateral or margin, the right to terminate transactions or to obtain collateral should unfavorable events occur, the right to call for collateral when certain exposure thresholds are exceeded, the right to call for third party guarantees and the purchase of credit default protection. With senior management involvement, we conduct regular portfolio reviews, monitor counterparty creditworthiness, and evaluate potential transaction risks with a view toward early problem identification and protection against unacceptable credit-related losses. We continue to invest additional resources to enhance Merrill Lynch's methods and policies to assist in managing our credit risk and to address evolving regulatory requirements.

Senior members of the Global Credit and Commitments Group chair various commitment committees with membership across business, control and support units. These committees review and approve commitments, underwritings and syndication strategies related to debt, syndicated loans, equity, real estate and asset-based finance, among other products and activities.

Commercial Lending

Our commercial lending activities consist primarily of corporate and institutional lending, asset-based finance, commercial finance, and commercial real estate related activities. In evaluating certain potential commercial lending transactions, we use a risk-adjusted-return-on-capital model in addition to other methodologies. We typically provide corporate and institutional lending facilities to clients for general corporate purposes, backup liquidity lines, bridge financings, and acquisition-related activities. We often syndicate corporate and institutional loans through assignments and participations to unaffiliated third parties. While these facilities may be supported by credit enhancing arrangements such as property liens or claims on operating assets, we generally expect repayment through other sources including cash flow and/or recapitalization. As part of portfolio management activities, the Global Credit and Commitments Group mitigates certain exposures in the corporate and institutional lending portfolio by purchasing single name and basket credit default swaps as well as by evaluating and selectively executing loan sales in the secondary markets.

Asset-based finance facilities are typically secured by financial assets such as mortgages, auto loans, leases, credit card and other receivables. Clients often use these facilities for the origination and purchase of assets during a warehousing period leading up to securitization.

Credit assessment for these facilities relies primarily on the amount, asset type, quality, and liquidity of the supporting collateral, as the collateral is the expected source of repayment. Limits are monitored against potential loss upon default taking these factors into consideration.

Our commercial finance activities primarily consist of corporate finance, healthcare finance, equipment finance and commercial real estate lending to qualifying business clients. Substantially all of these facilities are secured by liens on property, plant, and equipment, third party guarantees or other similar arrangements. Our other commercial real estate related activities consist of commercial mortgage originations and other extensions of credit connected to the financing of commercial properties or portfolios of properties. We may reduce or eliminate these exposures through third-party syndications or securitizations. Our assessment of creditworthiness and credit approval is highly dependent upon the anticipated performance of the underlying property and/or associated cash flows.

The following tables present a distribution of commercial loans and closed commitments by credit quality, industry and country for year-end 2006, gross of allowances for loan losses and reserves, without considering the impact of purchased credit protection. Closed commitments represent the unfunded portion of existing commitments available for draw down and do not include contingent commitments extended but not yet closed. These tables do not include our large, diversified portfolio of loans and commitments to small- and middle-market businesses, totaling approximately \$3.1 billion in loans and \$2.1 billion in closed commitments as of December 29, 2006. The majority of these counterparties carry non-investment grade ratings and are predominantly domiciled in the United States.

(dollars in millions) By Credit Quality ⁽¹⁾	Loans		Closed Commitments	
	Secured	Unsecured	Secured	Unsecured
AA or above	\$ 12,216	\$ 19	\$ 6,549	\$ 16,377
A	2,566	1,180	2,251	11,191
BBB	6,648	1,671	2,143	8,150
BB	12,587	1,323	6,613	966
Other	9,250	422	6,059	570
Total	\$ 43,267	\$ 4,615	\$ 23,615	\$ 37,254

(1) Based on credit rating agency equivalent of internal credit ratings.

By Industry	Loans		Closed Commitments	
	Secured	Unsecured	Secured	Unsecured
Financial Institutions	36%	11%	32%	20%
Consumer Goods and Services	22	32	22	46
Real Estate	18	12	8	2
Industrial/Manufacturing Goods and Services	4	1	11	6
Technology/Media/Telecommunications	3	30	7	8
Energy/Utilities	1	9	5	12
All Other	16	5	15	6
Total	100%	100%	100%	100%

By Country	Loans		Closed Commitments	
	Secured	Unsecured	Secured	Unsecured
United States	62%	64%	80%	50%
United Kingdom	16	3	7	4
Japan	6	5	—	33
Germany	2	2	—	6
France	2	1	6	1
All Other	12	25	7	6
Total	100%	100%	100%	100%

As of December 29, 2006, our largest commercial lending industry concentration was to consumer goods and services. Commercial borrowers were predominantly domiciled in the United States or had principal operations tied to the United States or its economy. The majority of all outstanding commercial loan balances had a remaining maturity of less than three years. Additional detail on our commercial lending related activities can be found in Note 8 to the Consolidated Financial Statements.



Residential Mortgage Lending

We originate and purchase residential mortgage loans, certain of which include features that may result in additional credit risk when compared to more traditional types of mortgages. The potential additional credit risk arising from these mortgages is addressed through adherence to underwriting guidelines as described below. Credit risk is closely monitored in order to confirm that reserves are sufficient and valuations are appropriate. These loans are predominantly extended to high credit quality borrowers and include:

- Loans where the borrower is subject to payment increases over the life of the loan including:
 - Interest-only loans where the borrower makes no principal payments on the loan during an initial period and is required to make both interest and principal payments either during the later stages of the loan or in one lump sum at maturity. These loans therefore require the borrower to make larger payments later in the life of the loans if the loans are not otherwise repaid through a refinancing or sale of the property. These loans are underwritten based on a variety of factors including, for example, the borrower's credit history, the debt-to-income ratio, employment, the loan-to-value ("LTV") ratio on the property, and the borrower's disposable income and cash reserves; typically using a qualifying formula that assesses the borrower's ability to make interest payments at a minimum of 2% above the initial rate. In instances where the borrower is of lower credit standing, the loans are typically underwritten to have a lower LTV ratio and/or other mitigating factors. Interest-only loans are the significant majority of the loans that we hold where the borrower may be subject to payment increases.
 - Loans with low rates early in the loan term. We offer these loans primarily in the United Kingdom. The loans are underwritten based on the borrower's ability to make the principal and interest payments, and borrowers of a lower credit standing are typically underwritten to a lower LTV ratio.
- High LTV ratio loans where the principal amount of the loan is greater than 80% of the value of the mortgaged property and the borrower is not required to obtain private mortgage insurance ("PMI"), and/or loans where a mortgage and home equity loan are simultaneously established for the same property. Under our policy, the maximum LTV ratio for originated residential mortgages with no PMI or other security is 95%. High LTV ratio loans also include Merrill Lynch's Mortgage100SM product. The Mortgage100SM product permits borrowers to pledge securities in lieu of a cash down payment. The securities are subject to daily monitoring and additional collateral is required if the value of the pledged securities declines below certain levels. The LTV on real estate collateral in the Mortgage 100SM program typically does not exceed 70%.

The following table shows the percentages of these types of loans compared to the overall residential mortgage portfolio held in loans, notes, and mortgages:

	Loan and Unfunded Commitment Balance as a % of all Residential Mortgages and Unfunded Residential Commitments at December 29, 2006 ⁽²⁾	Originated/Purchased Loans as a % of all Residential Mortgages Originated/Purchased during 2006
Loans where borrowers may be subject to payment increases ⁽¹⁾	65%	54%
Loans with high LTV ratios	8	5
Loans with both high LTV ratios and loans where borrowers may be subject to payment increases	21	17
Total	94%	76%

(1) Includes interest-only loans and loans with low initial rates.

(2) Total residential mortgages were \$18.3 billion and unfunded commitments were \$7.7 billion as of December 29, 2006.

Approximately half of the high LTV ratio loans were made to borrowers in the United States; the majority of the remaining loans were made to borrowers in the United Kingdom. Approximately 5% of the loans where the borrower is subject to payment increases were made to borrowers in the United Kingdom; the majority of the remaining loans were made to borrowers in the United States. The majority of these loans are with high credit quality borrowers.

We do not currently originate or purchase residential mortgage loans that allow for minimum monthly payments less than the interest accrued on the loan (i.e., negative amortizing loans) or option adjustable rate mortgages.

During the third quarter of 2006, Merrill Lynch announced an agreement to acquire the First Franklin mortgage origination franchise and related servicing platform which is focused on originating non-prime residential mortgage loans through a wholesale network. As a result of this acquisition which was completed in the fiscal first quarter of 2007, the credit profile of our mortgage lending portfolio may be impacted in future periods.

Derivatives

We enter into International Swaps and Derivatives Association, Inc. master agreements or their equivalent ("master netting agreements") with substantially all of our derivative counterparties as soon as possible. Master netting agreements provide protection in bankruptcy in certain circumstances and, in some cases, enable receivables and payables with the same counterparty to be offset for risk management purposes. Agreements are negotiated bilaterally and can require complex terms. While we make every effort to execute such agreements, it is possible that a counterparty may be unwilling to sign such an agreement and, as a result, would subject us to additional credit risk. The enforceability of master netting agreements under bankruptcy laws in certain countries or in certain industries is not free from doubt, and receivables and payables with counterparties in these countries or industries are accordingly recorded on a gross basis.

In addition, to reduce the risk of loss, we require collateral, principally cash and U.S. Government and agency securities, on certain derivative transactions. From an economic standpoint, we evaluate risk exposures net of related collateral that meets specified standards. See Note 1 to the Consolidated Financial Statements for additional information.

The following is a summary of counterparty credit ratings for the replacement cost (net of \$11.5 billion of collateral, of which \$7.2 billion represented cash collateral) of OTC trading derivatives in a gain position by maturity at December 29, 2006.

(dollars in millions) Credit Rating ⁽¹⁾	Years to Maturity				Cross-Maturity	Total
	0 to 3	3+ to 5	5+ to 7	Over 7	Netting ⁽²⁾	
AA or Above	\$ 4,711	\$ 1,552	\$ 1,243	\$ 4,830	\$ (2,175)	\$ 10,161
A	2,771	1,391	965	3,293	(1,863)	6,557
BBB	1,494	435	278	1,591	(416)	3,382
BB	365	369	133	221	(158)	930
Other	3,986	673	333	1,127	(400)	5,719
Total	\$ 13,327	\$ 4,420	\$ 2,952	\$ 11,062	\$ (5,012)	\$ 26,749

(1) Represents credit rating agency equivalent of internal credit ratings.

(2) Represents netting of payable balances with receivable balances for the same counterparty across maturity band categories. Receivable and payable balances with the same counterparty, within the same maturity category, are netted within that maturity category.

In addition to obtaining collateral, we attempt to mitigate our default risk on derivatives whenever possible by entering into transactions with provisions that enable us to terminate or reset the terms of our derivative contracts.

Liquidity Risk

We define liquidity risk as the potential inability to meet financial obligations, on- or off-balance sheet, as they come due. Liquidity risk relates to the ability of a company to repay short-term borrowings with new borrowings or with assets that can be quickly converted into cash while meeting other obligations and continuing to operate as a going concern. This is particularly important for financial services firms. Liquidity risk also includes both the potential inability to raise funding with appropriate maturity, currency and interest rate characteristics and the inability to liquidate assets in a timely manner at a reasonable price. We actively manage the liquidity risks in our business that can arise from asset-liability mismatches, credit sensitive funding, commitments or contingencies.

The Liquidity Risk Management Group is responsible for measuring, monitoring and controlling our liquidity risks. This group establishes methodologies and specifications for measuring liquidity risks, performs scenario analysis and liquidity stress testing, and sets and monitors liquidity limits. The group works with our business units to limit liquidity risk exposures and reviews liquidity risks associated with new products and new business strategies. The Liquidity Risk Management Group also reviews liquidity risk with other independent risk and control groups and Treasury Management in Asset/Liability Committee meetings.

Our primary liquidity objectives are to ensure liquidity through market cycles and periods of financial stress and to ensure that all funding requirements and unsecured debt obligations that mature within one year can be met without issuing new unsecured debt or requiring



liquidation of business assets. In managing liquidity, we place significant emphasis on monitoring the near term cash flow profiles and exposures through extensive scenario analysis and stress testing. To achieve our objectives, we have established a set of liquidity management practices that are outlined below:

- Maintain excess liquidity in the form of unencumbered liquid assets and committed credit facilities;
- Match asset and liability profiles appropriately;
- Perform scenario analysis and stress testing; and
- Maintain a well formulated and documented contingency funding plan, including access to lenders of last resort.

Excess Liquidity and Unencumbered Assets

Consistent with our objectives, we maintain excess liquidity at ML & Co. and selected subsidiaries in the form of cash and high quality unencumbered liquid assets, which represent our “Global Liquidity Sources” and serve as our primary source of liquidity risk protection. We maintain these sources of liquidity at levels we believe are sufficient to sustain Merrill Lynch in the event of stressed liquidity conditions. In assessing liquidity, we monitor the extent to which the unencumbered assets are available as a source of funds, taking into consideration any regulatory or other restrictions that may limit the availability of unencumbered assets of subsidiaries to ML & Co. or other subsidiaries.

As of December 29, 2006 and December 30, 2005, the Global Liquidity Sources were \$178 billion and \$136 billion, respectively, consisting of the following:

(dollars in billions)	December 29, 2006	December 30, 2005
Excess liquidity pool	\$ 63	\$ 37
Unencumbered assets at regulated bank subsidiaries	57	53
Unencumbered assets at regulated non-bank subsidiaries	58	46
Global Liquidity Sources	\$ 178	\$ 136

The excess liquidity pool is maintained at, or readily available to, ML & Co. and can be deployed to meet cash outflow obligations under stressed liquidity conditions. The excess liquidity pool includes cash and cash equivalents, investments in short-term money market mutual funds, U.S. government and agency obligations and other liquid securities. At December 29, 2006 and December 30, 2005, the total carrying value of the excess liquidity pool, net of related hedges, was \$63 billion and \$37 billion, respectively, which included liquidity sources at subsidiaries that we believe are available to ML & Co. without restrictions. We regularly test our ability to access all components of our excess liquidity pool. We fund our excess liquidity pool with debt that has an appropriate term maturity structure. Additionally, our policy is to fund at least \$15 billion of our excess liquidity pool with debt that has a remaining maturity of at least one year. At December 29, 2006, the amount of our excess liquidity pool funded with debt with a remaining maturity of at least one year exceeded this requirement.

We manage the size of our excess liquidity pool by taking into account the potential impact of unsecured debt maturities, normal business volatility, cash and collateral outflows under various stressed scenarios, and stressed draws for unfunded commitments and contractual obligations. At December 29, 2006, our excess liquidity pool and other liquidity sources including maturing short-term assets and committed credit facilities, significantly exceeded short-term obligations and other contractual and contingent cash outflows based on our estimates.

At December 29, 2006 and December 30, 2005, unencumbered liquid assets of \$57 billion and \$53 billion, respectively, in the form of unencumbered high investment grade asset-backed securities and prime residential mortgage-backed securities were available at our regulated bank subsidiaries to meet potential deposit obligations, business activity demands and stressed liquidity needs of the bank subsidiaries. Our liquidity model conservatively assumes that these unencumbered assets are restricted from transfer and unavailable as a liquidity source to ML & Co. and other non-bank subsidiaries.

At December 29, 2006 and December 30, 2005, our regulated non-bank subsidiaries, including broker-dealer subsidiaries, maintained \$58 billion and \$46 billion, respectively, of unencumbered securities, which are an important source of liquidity for broker-dealer activities and other individual subsidiary financial commitments. These unencumbered securities are generally restricted from transfer and unavailable to support liquidity needs of ML & Co. or other subsidiaries.

Committed Credit Facilities

In addition to the Global Liquidity Sources, we maintain credit facilities that are available to cover immediate and contingent funding needs. We maintain a committed, multi-currency, unsecured bank credit facility that totaled \$4.5 billion and \$4.0 billion at December 29, 2006

and December 30, 2005, respectively. This 364-day facility permits borrowings by ML & Co. and select subsidiaries and expires in June 2007. The facility includes a one-year term-out feature that allows ML & Co., at its option, to extend borrowings under the facility for an additional year beyond the expiration date in June 2007. At December 29, 2006 and December 30, 2005, we had no borrowings outstanding under this credit facility, although we do borrow regularly from it.

We also maintain two committed, secured credit facilities which totaled \$7.5 billion at December 29, 2006 and \$5.5 billion at December 30, 2005. One of these facilities is multi-currency and includes a tranche of \$1.2 billion that is available on an unsecured basis, at our option. These facilities expire in May 2007 and December 2007. Both facilities include a one-year term-out feature that allows ML & Co., at its option, to extend borrowings under the facilities for an additional year beyond their respective expiration dates. The secured facilities permit borrowings by ML & Co. and select subsidiaries, secured by a broad range of collateral. At December 29, 2006 and December 30, 2005, we had no borrowings outstanding under either facility.

In addition, we maintain committed, secured credit facilities with two financial institutions that totaled \$11.75 billion at December 29, 2006 and \$6.25 billion at December 30, 2005. The secured facilities may be collateralized by government obligations eligible for pledging. The facilities expire at various dates through 2014, but may be terminated earlier with at least a nine-month notice by either party. At December 29, 2006 and December 30, 2005, we had no borrowings outstanding under these facilities.

Asset-Liability Management

We manage the profiles of our assets and liabilities and the relationships between them with the objective of ensuring that we maintain sufficient liquidity to meet our funding obligations in all environments, including periods of financial stress. This asset-liability management involves maintaining the appropriate amount and mix of financing related to the underlying asset profiles and liquidity characteristics, while monitoring the relationship between cash flow sources and uses. Our asset-liability management takes into account restrictions at the subsidiary level with coordinated and centralized oversight at ML & Co. We consider a legal entity focus essential in view of the regulatory, tax and other considerations that can affect the transfer and availability of liquidity between legal entities. We assess the availability of cash flows to fund maturing liability obligations when due under stressed market liquidity conditions in time frames from overnight through one year, with an emphasis on the near term periods during which liquidity risk is considered to be the greatest.

An important objective of our asset-liability management is ensuring that sufficient funding is available for our long-term assets and other long-term capital requirements. Long-term capital requirements are determined using a long-term capital model that takes into account:

- The portion of assets that cannot be self-funded in the secured financing markets, considering stressed market conditions, including illiquid and less liquid assets;
- Subsidiaries' regulatory capital;
- Collateral on derivative contracts that may be required in the event of changes in our credit ratings or movements in the underlying instruments;
- Portions of commitments to extend credit based on our estimate of the probability of draws on these commitments; and
- Other contingencies based on our estimates.

In assessing the appropriateness of our long-term capital, we seek to: (1) ensure sufficient matching of our assets based on factors such as holding period, contractual maturity and regulatory restrictions and (2) limit the amount of liabilities maturing in any particular period. We also consider liquidity needs for business growth and circumstances that might cause contingent liquidity obligations. Our policy is to operate with an excess of long-term capital sources of at least \$15 billion over our long-term capital requirements. At December 29, 2006, our long-term capital sources of \$240.1 billion exceeded our estimated long-term capital requirements by more than \$15 billion.

Our regulated bank subsidiaries maintain strong liquidity positions and manage the liquidity profile of their assets, liabilities and commitments so that they can appropriately balance cash flows and meet all of their deposit and other funding obligations when due. This asset-liability management includes: projecting cash flows, monitoring balance sheet liquidity ratios against internal and regulatory requirements, monitoring depositor concentrations, and maintaining liquidity and contingency plans. In managing liquidity, our bank subsidiaries place emphasis on a stable and diversified retail deposit base, which serves as a reliable source of liquidity. The banks' liquidity models use behavioral and statistical approaches to measure and monitor the liquidity characteristics of the deposits.

Our asset-liability management process also focuses on maintaining diversification and appropriate mix of borrowings through application and monitoring of internal concentration limits and guidelines on various factors, including debt instrument types, maturities, currencies, and single investors.



Scenario Analysis and Stress Testing

Scenario analysis and stress testing is an important part of our liquidity management process. Our Liquidity Risk Management Group performs regular scenario-based stress tests covering credit rating downgrades and stressed market conditions both market-wide and in specific market segments. We run scenarios covering crisis durations ranging from as short as one week through as long as one year. Some scenarios assume that normal business is not interrupted.

In our scenario analysis, we assume loss of access to unsecured funding markets during periods of financial stress. Various levels of severity are assessed through sensitivity analysis around key liquidity risk drivers and assumptions. Key assumptions that are stressed include diminished access to the secured financing markets, run-off in deposits, draws on liquidity facilities, and derivative collateral outflows. We assess the liquidity sources that can be accessed during the crisis and the residual positions.

Management judgment is applied in scenario modeling. The Liquidity Risk Management Group works with our Credit and Market Risk Management groups to incorporate the results of their judgment and analytics where credit or market risk implications exist. We assess the cash flow exposures under the various scenarios and use the results to refine liquidity assumptions, size our excess liquidity pools and/or adjust the asset-liability profiles.

Contingency Funding Plan

We maintain a contingency funding plan that outlines our responses to liquidity stress events of various levels of severity. The plan includes the funding action steps, potential funding strategies and a range of communication procedures that we will implement in the event of stressed liquidity conditions. We periodically review and test the contingency funding plan to achieve ongoing validity and readiness.

Our U.S. bank subsidiaries also retain access to contingency funding through the Federal Reserve discount window and Federal Home Loan Banks, while certain non-U.S. subsidiaries have access to central banks. While we do not rely on these sources in our liquidity modeling, we maintain the policies, procedures and governance processes that would enable us to access these sources.

Operational Risk

We define operational risk as the risk of loss resulting from the failure of people, internal processes and systems or from external events. The primary responsibility for managing operational risk on a day-to-day basis lies with our businesses and support groups. The Operational Risk Management Group provides the framework within which these groups manage operational risk. These groups manage operational risk in a number of ways, including the use of technology to automate processes; the establishment of policies and key controls; the provision and testing of business continuity plans; and the training, supervision, and development of staff.

The Operational Risk Management Group has established our approach to operational risk management through the documentation of key principles and policies. The group provides an independent assessment of operational risk through the monitoring and reporting of risk exposures and loss events. This includes analysis and reporting of internal and external losses in order to provide a comprehensive profile of the risk exposure facing the industry and Merrill Lynch. The group works closely with our businesses and other independent risk and control groups in assessing and managing operational risks.

Other Risks

We encounter a variety of other risks, which could have the ability to impact the viability, profitability, and cost-effectiveness of present or future transactions. Such risks include political, tax, and regulatory risks that may arise due to changes in local laws, regulations, accounting standards, or tax statutes. To assist in the mitigation of such risks, we rigorously review new and pending legislation and regulations. Additionally, we employ professionals in jurisdictions in which we operate to actively follow issues of potential concern or impact to Merrill Lynch and to participate in related interest groups.

Non-Investment Grade Holdings and Highly Leveraged Transactions

Non-investment grade holdings and highly leveraged transactions involve risks related to the creditworthiness of the issuers or counterparties and the liquidity of the market for such investments. We recognize these risks and, whenever possible, employ strategies to mitigate exposures. The specific components and overall level of non-investment grade and highly leveraged positions may vary significantly from period-to-period as a result of inventory turnover, investment sales, and asset redeployment.

In the normal course of business, we underwrite, trade, and hold non-investment grade cash instruments in connection with our investment banking, market-making, and derivative structuring activities. Non-investment grade holdings are defined as debt and preferred equity securities rated lower than BBB or equivalent ratings by recognized credit rating agencies, sovereign debt in emerging markets, amounts due under derivative contracts from non-investment grade counterparties, and other instruments that, in the opinion of management, are non-investment grade.

In addition to the amounts included in the following table, we may also be exposed to credit risk through derivatives related to the underlying security where a derivative contract can either replicate ownership of the underlying security (e.g., long total return swaps) or potentially force ownership of the underlying security (e.g., short put options). Derivatives may also subject us to credit spread or issuer default risk, in that changes in credit spreads or in the credit quality of the underlying securities may adversely affect the derivatives' fair values. We seek to manage these risks by engaging in various hedging strategies to reduce our exposure associated with non-investment grade positions, such as purchasing an option to sell the related security or entering into other offsetting derivative contracts.

We provide financing and advisory services to, and invest in, companies entering into leveraged transactions, which may include leveraged buyouts, recapitalizations, and mergers and acquisitions. On a selected basis, we provide extensions of credit to leveraged companies, in the form of senior and subordinated debt, as well as bridge financing. In addition, we syndicate loans for non-investment grade companies or in connection with highly leveraged transactions and may retain a portion of these loans.

We hold direct equity investments in leveraged companies and interests in partnerships that invest in leveraged transactions. We have also committed to participate in limited partnerships that invest in leveraged transactions. We anticipate that we will continue to make future commitments to participate in limited partnerships and other direct equity investments on a selective basis.

Trading Exposures

The following table summarizes our trading exposures to non-investment grade or highly leveraged corporate issuers or counterparties at year-end 2006 and 2005:

(dollars in millions)	2006	2005
Trading assets:		
Cash instruments	\$ 26,855	\$ 15,578
Derivatives	9,661	6,750
Trading liabilities – cash instruments	(4,034)	(3,400)
Collateral on derivative assets	(3,012)	(3,123)
Net trading asset exposure	\$ 29,470	\$ 15,805

Included in the preceding table are debt and equity securities and traded bank loans of companies in various stages of bankruptcy proceedings or in default. At December 29, 2006, the carrying value of such debt and equity securities totaled \$618 million, of which 49% resulted from our market-making activities in such securities. This compared with \$900 million at December 30, 2005, of which 61% related to market-making activities. Also included are distressed bank loans totaling \$219 million and \$290 million at year-end 2006 and 2005, respectively.

Non-Trading Exposures

The following table summarizes our non-trading exposures to non-investment grade or highly leveraged corporate issuers or counterparties at year-end 2006 and 2005. This table excludes lending-related exposures which are included in the Credit Risk section of Risk Management.

(dollars in millions)	2006	2005
Investment securities	\$ 900	\$ 524
Other investments ⁽¹⁾ :		
Partnership interests	4,710	2,223
Other equity investments ⁽²⁾	4,284	2,086
Other assets	618	76

(1) Includes a total of \$777 million and \$556 million in investments held by employee partnerships at year-end 2006 and 2005, respectively, for which a portion of the market risk of the investments rests with the participating employees.

(2) Includes investments in 155 and 167 enterprises at year-end 2006 and 2005, respectively.



In addition, we had commitments to non-investment grade or highly leveraged corporate issuers or counterparties of \$1.6 billion and \$1.2 billion at year-end 2006 and 2005, respectively, which primarily relate to commitments to invest in partnerships.

At December 29, 2006, our single largest non-investment grade industry exposure was to the Technology/Media/Telecommunication sector, principally within the media and entertainment industry.

Recent Accounting Developments

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Liabilities* ("SFAS No. 159"). SFAS No. 159 provides a fair value option election that allows companies to irrevocably elect fair value as the initial and subsequent measurement attribute for certain financial assets and liabilities, with changes in fair value recognized in earnings as they occur. SFAS No. 159 permits the fair value option election on an instrument by instrument basis at initial recognition of an asset or liability or upon an event that gives rise to a new basis of accounting for that instrument. SFAS No. 159 is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. Early adoption is permitted as of the beginning of a fiscal year that begins on or before November 15, 2007 provided that the entity makes that choice in the first 120 days of that fiscal year, has not yet issued financial statements for any interim period of the fiscal year of adoption, and also elects to apply the provisions of Statement No. 157, *Fair Value Measurements* ("SFAS No. 157"). We intend to early adopt SFAS No. 159 as of the first quarter of fiscal 2007 and are currently assessing the impact of adoption on the Consolidated Financial Statements.

In September 2006, the FASB issued SFAS No. 157. SFAS No. 157 defines fair value, establishes a framework for measuring fair value and enhances disclosure about fair value measurements. SFAS No. 157 nullifies the guidance provided by the Emerging Issues Task Force on Issue 02-3, *Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities* ("EITF 02-3") that prohibits recognition of day one gains or losses on derivative transactions where model inputs that significantly impact valuation are not observable. In addition, SFAS No. 157 prohibits the use of block discounts for large positions of unrestricted financial instruments that trade in an active market and requires an issuer to incorporate changes in its own credit spreads when determining the fair value of its liabilities. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007 with early adoption permitted provided that the entity has not yet issued financial statements for that fiscal year, including any interim periods. The provisions of SFAS No. 157 are to be applied prospectively, except that the provisions related to block discounts and existing derivative financial instruments measured under EITF 02-3 are to be applied as a one-time cumulative effect adjustment to opening retained earnings in the year of the adoption. We intend to early adopt SFAS No. 157 as of the first quarter of fiscal 2007 and do not expect the adoption to have a material impact on the Consolidated Financial Statements.

In September 2006, the FASB issued SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106 and 132R* ("SFAS No. 158"). SFAS No. 158 requires an employer to recognize the overfunded or underfunded status of its defined benefit pension and other postretirement plans, measured as the difference between the fair value of plan assets and the benefit obligation as an asset or liability in its statement of financial condition. Upon adoption, SFAS No. 158 requires an entity to recognize previously unrecognized actuarial gains and losses and prior service costs within accumulated other comprehensive income (loss), net of tax. In accordance with the guidance in SFAS No. 158, we adopted this provision of the standard for year-end 2006. The adoption of SFAS No. 158 resulted in a net credit of \$65 million to accumulated other comprehensive loss recorded on the Consolidated Financial Statements at December 29, 2006. See Note 13 to the Consolidated Financial Statements for further information regarding the incremental effect of applying this provision. SFAS No. 158 also requires defined benefit plan assets and benefit obligations to be measured as of the date of the company's fiscal year-end. We have historically used a September 30 measurement date. Under the provisions of SFAS No. 158, we will be required to change our measurement date to coincide with our fiscal year-end. This provision of SFAS No. 158 will be effective for us in fiscal 2008. We are currently assessing the impact of adoption of this provision of SFAS No. 158 on the Consolidated Financial Statements.

In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 108 ("SAB No. 108") to provide guidance on how the effects of the carryover or reversal of prior year unrecorded misstatements should be considered in quantifying a current year misstatement. SAB 108 requires a company to apply an approach that considers the amount by which the current year income statement is misstated ("rollover approach") and an approach that considers the cumulative amount by which the current year balance sheet is misstated ("iron-curtain approach"). Prior to the issuance of SAB No. 108, many companies applied either the rollover or iron-curtain approach for purposes of assessing materiality of misstatements. SAB No. 108 is effective for fiscal years ending after November 15, 2006. Upon adoption, SAB No. 108 allows a one-time cumulative effect adjustment against retained earnings for those prior year misstatements that were not material under a company's prior approach, but that are deemed material under SAB No. 108. Adoption of SAB No. 108 did not have a material impact on the Consolidated Financial Statements.

In June 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109* ("FIN 48"). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in a company's financial statements and prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position

taken or expected to be taken in a tax return. The Interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 will be effective for us beginning in the first quarter of 2007. We do not expect the impact of adoption of FIN 48 to be material to the opening balance of retained earnings.

In April 2006, the FASB issued a FASB Staff Position FIN 46(R)-6, *Determining the Variability to be Considered in Applying FIN 46R* ("the FSP"). The FSP requires that the variability to be included when applying FIN 46R be based on a "by-design" approach and should consider what risks the variable interest entity was designed to create. We adopted the FSP beginning in the third quarter of 2006 for all new entities with which we became involved. We will apply the provisions of the FSP to all entities previously required to be analyzed under FIN 46R when a reconsideration event occurs as defined under paragraph 7 of FIN 46R. The adoption of the FSP during the third quarter did not have a material impact on the Consolidated Financial Statements.

In March 2006, the FASB issued Statement No. 156, *Accounting for Servicing of Financial Assets* ("SFAS No. 156"). SFAS No. 156 amends Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, to require all separately recognized servicing assets and servicing liabilities to be initially measured at fair value, if practicable. SFAS No. 156 also permits servicers to subsequently measure each separate class of servicing assets and liabilities at fair value rather than at the lower of amortized cost or market. For those companies that elect to measure their servicing assets and liabilities at fair value, SFAS No. 156 requires the difference between the carrying value and fair value at the date of adoption to be recognized as a cumulative-effect adjustment to retained earnings as of the beginning of the fiscal year in which the election is made. We will adopt SFAS No. 156 beginning in the first quarter of 2007. We do not expect the impact of adopting SFAS No. 156 to have a material impact on the Consolidated Financial Statements.

In February 2006, the FASB issued Statement No. 155, *Accounting for Certain Hybrid Financial Instruments an amendment of FASB Statements No. 133 and 140* ("SFAS No. 155"). SFAS No. 155 clarifies the bifurcation requirements for certain financial instruments and permits hybrid financial instruments that contain a bifurcable embedded derivative to be accounted for as a single financial instrument at fair value with changes in fair value recognized in earnings. This election is permitted on an instrument-by-instrument basis for all hybrid financial instruments held, obtained, or issued as of the adoption date. At adoption, any difference between the total carrying amount of the individual components of the existing bifurcated hybrid financial instruments and the fair value of the combined hybrid financial instruments will be recognized as a cumulative-effect adjustment to beginning retained earnings. We will adopt SFAS No. 155 on a prospective basis beginning in the first quarter of 2007. As a result, there will be no cumulative-effect adjustment on the Consolidated Financial Statements upon adoption of the standard.

During the first quarter of 2006, we adopted the provisions of Statement No. 123 (revised 2004), *Share-Based Payment*, a revision of SFAS No. 123, *Accounting for Stock-Based Compensation* ("SFAS No. 123R"). Under SFAS No. 123R, compensation expenses for share-based awards that do not require future service are recorded immediately, and share-based awards that require future service continue to be amortized into expense over the relevant service period. We adopted SFAS No. 123R under the modified prospective method whereby the provisions of SFAS No. 123R are generally applied only to share-based awards granted or modified subsequent to adoption. Thus, for Merrill Lynch, SFAS No. 123R required the immediate expensing of share-based awards granted or modified in 2006 to retirement-eligible employees, including awards that are subject to non-compete provisions.

Prior to the adoption of SFAS No. 123R, we had recognized expense for share-based compensation over the vesting period stipulated in the grant for all employees. This included those who had satisfied retirement eligibility criteria but were subject to a non-compete agreement that applied from the date of retirement through each applicable vesting period. Previously, we had accelerated any unrecognized compensation cost for such awards if a retirement-eligible employee left Merrill Lynch. However, because SFAS No. 123R applies only to awards granted or modified in 2006, expenses for share-based awards granted prior to 2006 to employees who were retirement-eligible with respect to those awards must continue to be amortized over the stated vesting period.

In addition, beginning with performance year 2006, for which we granted stock awards in January 2007, we accrued the expense for future awards granted to retirement-eligible employees over the award performance year instead of recognizing the entire expense related to the award on the grant date. Compensation expense for the 2006 performance year and all future stock awards granted to employees not eligible for retirement with respect to those awards will be recognized over the applicable vesting period.

SFAS No. 123R also requires expected forfeitures of share-based compensation awards for non-retirement-eligible employees to be included in determining compensation expense. Prior to the adoption of SFAS No. 123R, any benefits of employee forfeitures of such awards were recorded as a reduction of compensation expense when the employee left Merrill Lynch and forfeited the award. In the first quarter of 2006, we recorded a benefit based on expected forfeitures which was not material to the results of operations for the quarter.



The adoption of SFAS No. 123R resulted in a first quarter charge to compensation expense of approximately \$550 million on a pre-tax basis and \$370 million on an after-tax basis.

The adoption of SFAS No. 123R, combined with other business and competitive considerations, prompted us to undertake a comprehensive review of our stock-based incentive compensation awards, including vesting schedules and retirement eligibility requirements, examining their impact to both Merrill Lynch and its employees. Upon the completion of this review, the Management Development and Compensation Committee of Merrill Lynch's Board of Directors determined that to fulfill the objective of retaining high quality personnel, future stock grants should contain more stringent retirement provisions. These provisions include a combination of increased age and length of service requirements. While the stock awards of employees who retire continue to vest, retired employees are subject to continued compliance with the strict non-compete provisions of those awards. To facilitate transition to the more stringent future requirements, the terms of most outstanding stock awards previously granted to employees, including certain executive officers, were modified, effective March 31, 2006, to permit employees to be immediately eligible for retirement with respect to those earlier awards. While we modified the retirement-related provisions of the previous stock awards, the vesting and non-compete provisions for those awards remain in force.

Since the provisions of SFAS No. 123R apply to awards modified in 2006, these modifications required us to record additional one-time compensation expense in the first quarter of 2006 for the remaining unamortized amount of all awards to employees who had not previously been retirement-eligible under the original provisions of those awards.

The one-time, non-cash charge associated with the adoption of SFAS No. 123R, and the policy modifications to previous awards resulted in a net charge to compensation expense in the first quarter of 2006 of approximately \$1.8 billion pre-tax, and \$1.2 billion after-tax, or a net impact of \$1.34 and \$1.21 on basic and diluted earnings per share, respectively. Policy modifications to previously granted awards amounted to \$1.2 billion of the pre-tax charge and impacted approximately 6,300 employees.

Prior to the adoption of SFAS No. 123R, we presented the cash flows related to income tax deductions in excess of the compensation expense recognized on share-based compensation as operating cash flows in the Consolidated Statements of Cash Flows. SFAS No. 123R requires cash flows resulting from tax deductions in excess of the grant-date fair value of share-based awards to be included in cash flows from financing activities. The excess tax benefits of \$283 million related to total share-based compensation included in cash flows from financing activities in the first quarter of 2006 would have been included in cash flows from operating activities if we had not adopted SFAS No. 123R.

As a result of adopting SFAS No. 123R, approximately \$600 million of liabilities associated with the Financial Advisor Capital Accumulation Award Plan ("FACAAP") were reclassified to stockholders' equity. In addition, as a result of adopting SFAS No. 123R, the unamortized portion of employee stock grants, which was previously reported as a separate component of stockholders' equity on the Consolidated Balance Sheets, has been reclassified to paid-in capital. Refer to Note 14 to the Consolidated Financial Statements for additional information.

In June 2005, the FASB ratified the consensus reached by the Emerging Issues Task Force on Issue 04-5, *Determining Whether a General Partner, or the General Partners as a Group, Controls a Limited Partnership or Similar Entity When the Limited Partners Have Certain Rights* ("EITF 04-5"). EITF 04-5 presumes that a general partner controls a limited partnership, and should therefore consolidate a limited partnership, unless the limited partners have the substantive ability to remove the general partner without cause based on a simple majority vote or can otherwise dissolve the limited partnership, or unless the limited partners have substantive participating rights over decision making. The guidance in EITF 04-5 was effective beginning in the third quarter of 2005 for all new limited partnership agreements and any limited partnership agreements that were modified. For those partnership agreements that existed at the date EITF 04-5 was issued, the guidance became effective in the first quarter of 2006. The adoption of this guidance did not have a material impact on the Consolidated Financial Statements.

In December 2005, the FASB issued FASB Staff Position ("FSP") SOP 94-6-1, *Terms of Loan Products That May Give Rise to a Concentration of Credit Risk*. The guidance requires the disclosure of concentrations of loans with certain features that may increase the creditor's exposure to risk of nonpayment or realization. These loans are often referred to as "non-traditional" loans and include features such as high LTV ratios, terms that permit payments smaller than the interest accruals and loans where the borrower is subject to significant payment increases over the life of the loan. We adopted the provisions of this guidance in the fourth quarter of 2005. See Note 8 to the Consolidated Financial Statements for this disclosure.